

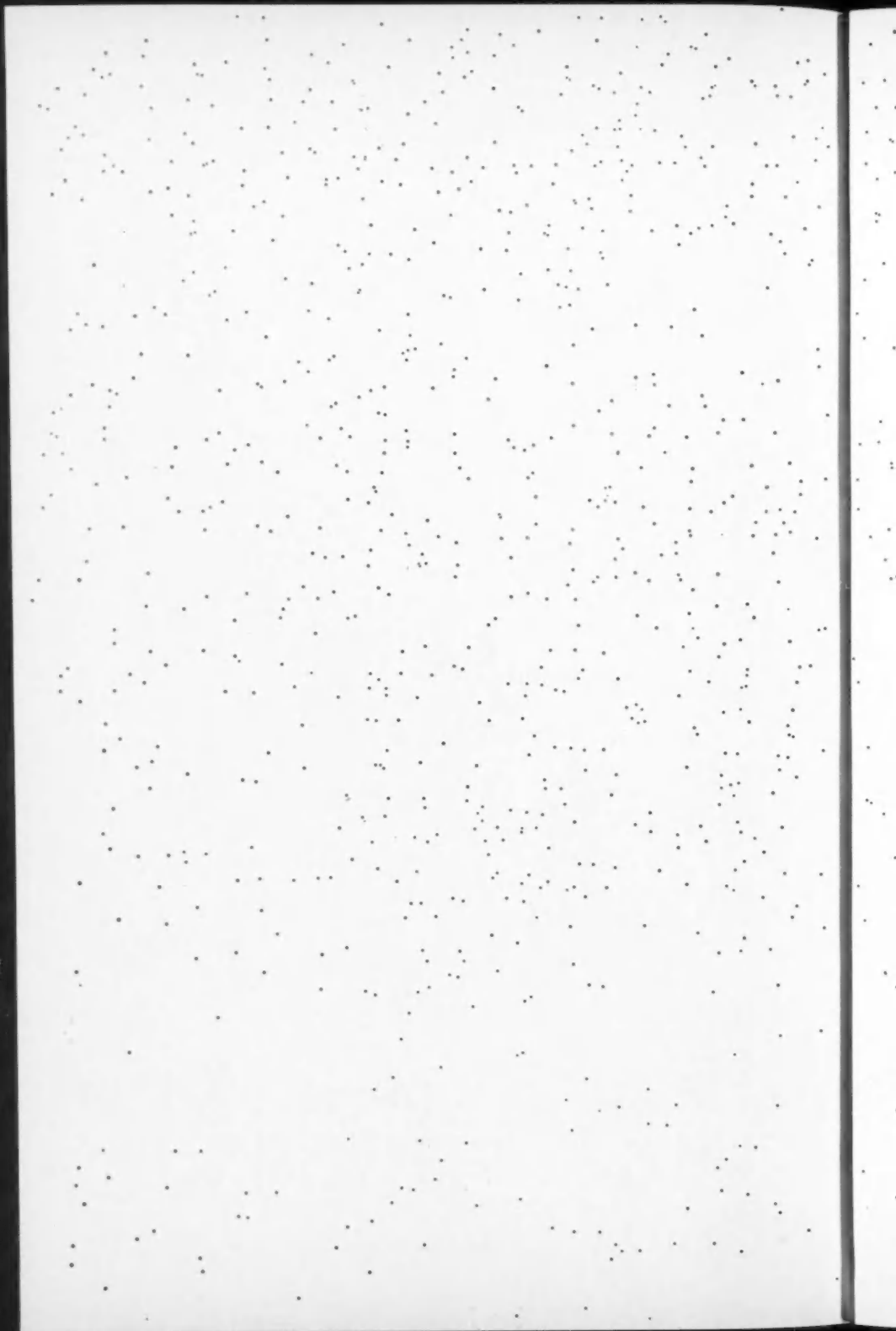
NATIONAL DEBT LIMIT

by

Martin Packman

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NATIONAL DEBT LIMIT

MOUNTING PRESSURE on the federal budget, produced by a combination of strong new defense demands on the spending side and a prospect of slipping tax receipts on the revenue side, now seems likely to force the administration to ask Congress to raise the statutory limit on the public debt. Secretary of the Treasury Anderson, testifying before the House Small Business Committee on Nov. 21, said that he did not "want to minimize the importance of maintaining a balanced budget" and that he thought the government should "make every effort to get by within the national debt limit." But he added that he "would not want to take any position of absolutism."

President Eisenhower told the nation, in an address broadcast from Oklahoma City on Nov. 13, that it was "time for another critical re-examination of our entire defense position." He said that "very considerable" additions would have to be made to current annual expenditures, and his description of moves necessary to ensure national safety left the impression that the budget to be sent to Congress in January would not be balanced. Because federal borrowings already approach the currently allowed maximum, a resumption of deficit financing would make unavoidable an increase in the present debt limit of \$275 billion.¹

Both political and economic considerations argue against heavier taxes in the immediate future. It therefore appears probable that additional borrowing cannot be long postponed if the United States is to meet threats to its security implied in Soviet scientific advances and at the same time carry on indispensable domestic and foreign activities.

Steps described by the President at Oklahoma City as requiring "most urgent attention" from a security stand-

¹ The debt ceiling, set at \$275 billion in 1946, was raised temporarily to \$281 billion for the fiscal years 1955 and 1956, lowered to \$278 billion for fiscal 1957, and allowed to revert last June 30 to \$275 billion.

point—such as acceleration of the dispersal of Strategic Air Command bases, development of defenses against missiles, improvement of radar warning lines; and pay increases for the armed services—will cost large amounts of money. Longer-term measures, including action to expand basic research, to improve science teaching, and induce more young people to qualify as scientists and engineers, also will involve federal as well as local and non-governmental outlays.

The fiscal impact of still unformulated long-term programs will not be felt at once. However, spending on the urgent items alone probably will add several billion dollars to the \$70 billion budget total set by the administration, before Russia orbited its sputniks, as the target for the fiscal year beginning July 1, 1958. President Eisenhower said on Nov. 13 that savings would have to be made by "cutting out or deferring entire categories of activity." But he added: "By whatever amount savings fail to equal the additional costs of security, our total expenditures will go up. Our people . . . will not sacrifice security worshipping a balanced budget."

TREASURY TROUBLES UNDER PRESENT DEBT LIMIT

During the past month the public debt subject to statutory limitation has been hovering around \$274 billion, and the balance in the general fund has been under \$4 billion.² The resulting leeway of about \$5 billion for Treasury operations falls \$1 billion short of that usually considered necessary to permit smooth handling of the government's financial transactions.

The Treasury now is heading into a period when revenue from corporation income taxes is relatively small. Corporations at present pay about 30 per cent of their annual tax bills in the second half of the calendar year, and the remaining 70 per cent in the first half, but collections are especially lean in the months of December, January, and February. Although the system is being altered to put collections on a fairly even quarterly basis, the change-over has not been completed.

Revenue from corporation income taxes will be affected next year by the decline in business activity. According

² The debt subject to statutory limitation stood at \$273.4 billion, and the general fund balance at \$3.9 billion, on Nov. 20. See footnote 7 for categories of debt not subject to statutory limitation.

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to the President's Council of Economic Advisers, corporation profits in the second quarter of 1957 were about a half-billion dollars lower than in the comparable period of 1956. If the business decline continues and becomes more pronounced,³ the ensuing reduction in tax yields would make Treasury operations under the current debt ceiling progressively more difficult.

FISCAL MANEUVERS TO AVOID PIERCING DEBT CEILING

The government already has had to resort to financial manipulation⁴ and to practice stringent economy to keep within the debt limit. Because Defense Department expenditures last spring piled up at an annual rate of more than \$41 billion, the Pentagon has been forced to take a whole series of actions to stay under the \$38 billion spending ceiling imposed by the current budget.

On two occasions within a space of about two months former Secretary of Defense Wilson ordered large-scale manpower cuts in the armed forces—a 100,000-man reduction on July 16 and another of the same size on Sept. 19. Wilson also directed the Army, Navy, and Air Force, early in August, to stop hiring civilians except in special cases and to reduce civilian payrolls by 50,000 to 60,000 persons.

Despite those and other economy measures, Defense Department expenditures continued at a rate which would have pushed the total to around \$40 billion by the end of the fiscal year. Wilson therefore ordered the three armed services, Aug. 12, to cut spending rates enough to avoid breaching the \$38 billion ceiling. The Air Force, biggest spender among the services, immediately called upon aircraft companies—except those engaged in ballistic missiles work—to reduce payroll costs by five per cent within two months.

The Pentagon announced the following day that, starting Sept. 1, so-called "progress payments" to military contractors would be reduced by five per cent. Progress payments consist of funds that the armed services advance to defense plants to help defray material and labor costs

³ It was the consensus of more than 60 leading economists meeting at the University of Michigan early in November that a continuing decline in over-all economic activity would cut \$2 billion from corporation profits in 1958.

⁴ At Treasury request, the Federal National Mortgage Association, which has authority to float loans not subject to the debt limit, borrowed around \$800 million from private sources to pay back money it had borrowed from the Treasury.

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pending full reimbursement upon contract completion. A further fund-rationing step was taken at the beginning of October, when the Air Force placed a ceiling on amounts it would pay suppliers each month.⁵

IMPACT OF SPUTNIKS ON EXPENDITURES FOR DEFENSE

Apprehension about the effects that continued economizing might have on American efforts to catch up with the Soviet Union in the missiles race led eventually to relaxation of the tight hold on spending. The Defense Department announced, Oct. 29, that it had been authorized to exceed its half-year budget ceiling of \$19 billion by \$400 million. Defense Secretary McElroy cautioned that the \$38 billion limit for the full year must be "kept in mind at all times," but he referred to it as an "objective" rather than a "ceiling." McElroy instructed the Army, Navy, and Air Force secretaries to advise him if they felt that further cuts would "jeopardize essential programs."

Assistant Secretary of the Navy J. Sinclair Armstrong, addressing the Navy League in New York on Oct. 30, said it was "obvious, with the Soviet menace what it is, and [in view of] the changing technology needed to meet it, that the amounts available this year are but interim spending figures, stepping stones, . . . on the road to very much larger appropriations and budgets for defense." How much larger future defense budgets will have to be is a subject of considerable speculation. The answer for the period directly ahead will not be spelled out authoritatively until President Eisenhower presents the new budget to Congress in January.

Sen. Styles H. Bridges (R-N.H.), ranking Republican member of both the Senate Appropriations Committee and the Senate Preparedness subcommittee which has just begun an investigation of the missile and satellite programs, said on Nov. 8 that defense spending might go up next year by as much as \$2 billion. Defense Secretary McElroy virtually matched that figure when he voiced the hope at Augusta, ten days later, that defense spending requests for fiscal 1959 would fall within a range of \$38 billion to \$40 billion. In view of the fact that the budget surplus for the current fiscal year (1958) is estimated at only \$1.5

⁵ After top industrialists had complained about the ceiling on payments, Defense Secretary McElroy declared, Oct. 29, that the armed services would "of course pay bills as they fall due." Air Force Secretary James H. Douglas announced the next day that the ceiling had been lifted.

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billion,⁶ an increase of as much as \$2 billion would put the question of increasing the debt limit squarely before Congress.

Composition and Growth of Federal Debt

WHEN REVENUES from taxes and other sources fail to provide sufficient funds to cover the expenditures of the federal government, the Treasury borrows money from a variety of institutions and individuals. In return it gives the lenders one or another of half-a-dozen different kinds of I.O.U.'s—Treasury bonds, bills, certificates of indebtedness, notes, U.S. savings bonds, and various special issues. The sum of these obligations outstanding comprises the public debt. Only a handful of federal securities is excluded⁷ in computing the total subject to the statutory debt limitation.

Most federal securities can be bought and sold in the securities markets, though certain savings and other types of bonds are not negotiable. Some government obligations (bills) fall due in as little as three months, some (certificates and notes) run from one to five years, and some (bonds) are payable within from five to 40 years.

About 70 per cent. of the public debt is owed to individuals, banks, corporations, and other investors; around 20 per cent to government trust funds, such as the social security fund; and approximately 10 per cent to the Federal Reserve System. Distribution of the obligations among different types of holders as of Dec. 31, 1956, latest date for which detailed figures are available, is shown in the table on the next page.

A public debt of the present magnitude is a comparatively recent phenomenon in the United States. Most of the existing debt was incurred to meet demands of World War II, the Korean war, and defense and other requirements of the free world in the East-West struggle. During the greater part of its history the United States has pur-

⁶ Budget Bureau's mid-year review, Oct. 1, 1957.

⁷ Panama Canal bonds, some matured securities on which interest has ceased, and certain items which bear no interest; the total amounted to \$446 million on June 30, 1957.

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OWNERSHIP OF PUBLIC DEBT, DEC. 31, 1956

| | Billions | Per cent |
|---|---------------|------------|
| Commercial banks | \$59.4 | 21 |
| U.S. government investment accounts | | |
| Social security | \$21.8 | |
| Unemployment insurance | 9.1 | |
| Federal employees retirement | 7.3 | |
| Veterans employees retirement | 6.7 | |
| Railroad retirement | 3.6 | |
| Others | 5.5 | |
| Total government accounts | 54.0 | 20 |
| Individuals holding savings bonds | 50.1 | 18 |
| Federal Reserve System | 24.9 | 9 |
| Corporations | 19.2 | 7 |
| Individuals holding securities other than savings bonds | 16.5 | 6 |
| Insurance companies | 12.8 | 4 |
| State and local governments | 10.8 | 4 |
| Mutual savings banks | 8.0 | 3 |
| Foreign and international accounts | 7.7 | 3 |
| Pension trust funds | 7.7 | 3 |
| Others (savings & loan assns., non-profit insts.) | 5.5 | 2 |
| Total | 276.6* | 100 |

*Total includes about \$500 million of securities not subject to the statutory debt limit.

SOURCE: Adapted from Treasury Department data.

sued a policy of rapidly paying off the debt accumulated during periods of war or economic adversity.

MODEST PROPORTIONS OF DEBT BEFORE THE CIVIL WAR

The public debt of the United States amounted to \$75 million in 1790, a year after formation of the new federal government. On the eve of the War of 1812 the debt stood at only \$45 million, but financing of 85 per cent of the cost of the war by borrowing raised the total by 1815 to a new high of \$127 million. Then, within 20 years, proceeds from sales of public lands virtually extinguished the national debt.

Federal borrowing during the period of economic stress following the panic of 1837 and during the Mexican War lifted aggregate obligations to more than \$68 million in mid-1851. The government was able to reduce the total to slightly under \$29 million within half-a-dozen years, when the panic of 1857 led to another substantial rise. The debt had climbed to more than \$64 million by the time the Civil War began.

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DEBT REDUCTION AFTER CIVIL WAR AND WORLD WAR I

The Civil War burdened the federal government with unprecedented expenses: By the end of the first year of the conflict, the public debt had mounted above \$90 million; in 1863 it crossed the billion dollar line for the first time; in 1866, a year after the end of the war, it reached a peak of \$2.7 billion. A quarter-century of Treasury surpluses enabled the government to whittle the debt down below \$1 billion by 1892. A slight further reduction the following year pared the total to \$961 million. It has never again been so low. In the next 20 years the national debt remained stable at a little over \$1 billion.

American participation in World War I ushered in a second period of great expansion of the public debt. Federal obligations outstanding jumped from \$1.2 billion in 1916 and \$2.9 billion in 1917 to \$25.5 billion in 1919. Postwar prosperity—there were 11 unbroken years of Treasury surpluses—made possible a record of debt retirement that astonished the world. By June 30, 1930, the national debt had been reduced to \$16.2 billion.

EXPANSION OF DEBT IN DEPRESSION AND WORLD WAR II

Substantial budget deficits, resulting from the deepening depression of the early 1930s, started the public debt upward again during the last half of the Hoover administration. For a time after President Roosevelt took office in 1933, he tried to balance the budget by cutting expenditures, but without success. Within a year he had been converted to a policy of heavy government spending to promote economic recovery,⁸ and support of consumer purchasing power thereafter became the prime consideration of New Deal fiscal policy. By 1939 the public debt had climbed to \$40.5 billion.

Preparedness measures taken after the outbreak of war in Europe and intensified after the fall of France brought new increases in the debt. The country's entry into the war in December 1941 then started the federal government on a course of borrowing that was to reach astronomical proportions. By mid-1942 the public debt had risen to \$72.5 billion. War expenditures pushed the total above \$100 billion in 1943 and above \$200 billion in 1944. The war-

⁸ British economist John Maynard Keynes, a White House caller in the spring of 1934, is generally credited with having convinced Roosevelt that deficit spending offered the quickest way to end the depression.

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incurred debt, reached a peak of nearly \$280 billion on Feb. 28, 1946. It then dropped back to \$269.4 billion at the end of the fiscal year on June 30, 1946—10½ months after hostilities ceased.

Budget surpluses in the next two years reduced the public debt to \$252.3 billion by June 1948. However, the Communist invasion of South Korea two years later and the ensuing expansion of all defense programs initiated still another rise in the debt. From a level of \$257.4 billion in June 1950, the total mounted to \$266 billion in mid-1953 and to an all-time peak of \$280.3 billion at the end of the calendar year 1955. A budget surplus in the fiscal year ended June 30, 1956, helped bring the total down to \$272.8 billion on that date. With another surplus the following year, the debt total was trimmed to \$270.5 billion on June 30, 1957.

EVOLUTION OF AND CHANGES IN OVERALL DEBT LIMIT

Subjection of all federal obligations, with a few exceptions, to an over-all debt ceiling is a comparatively new practice, although the totals outstanding have been effectively limited in other ways. The Second Liberty Bond Act of 1917 authorized issuance of bonds and Treasury certificates and limited the total amount of bonds to be issued and the total amount of certificates which might be outstanding at one time. Amendments of the act during and after World War I raised the prescribed limitations for bonds and certificates and added Treasury notes and bills to the authorized issues limited by categories.

Consolidation of the separate limitations began in 1935 when additional amendments to the 1917 act limited the amount of bonds outstanding at one time to \$25 billion and the amount of certificates, notes, and bills combined to \$20 billion. Congress in 1938 merged these two limitations into an aggregate ceiling of \$45 billion but retained a sort of sub-ceiling of \$30 billion on outstanding bonds. Finally, in 1939, that separate limitation was removed and an over-all ceiling of \$45 billion established without restrictions on the volume of the debt components.

Defense and war demands brought annual increases in the debt limit from 1940 through 1945, when the ceiling was fixed at the top figure of \$300 billion. The total was reduced to \$275 billion in 1946 and remained at that level

until 1954. The temporary increase of \$281 billion then allowed⁹ was cut back to \$278 billion in 1956 and allowed to lapse on June 30, 1957, when the effective ceiling again became \$275 billion.

Debt Management and Economic Health

BECAUSE the people of the United States are going to have to live with a mountainous national debt for many years to come, sound management of the outstanding debt is of enormous importance. Debt management—the determination of the composition, ownership, and maturity of the securities that make up the debt—exerts a major influence on the national economy. The Committee for Economic Development has pointed out:

Bad debt management, either a passive policy of doing nothing or a dogmatic policy of pursuing a fixed idea, can do the economy great harm. On the other hand, wise debt management can contribute to economic stability at a high level by improving the prevailing debt composition. . . .

Debt management is important primarily because it . . . [helps determine] whether we have high employment and economic growth and price stability, or inflation or depression. The main test of the quality of debt management is whether it contributes as much as it can to stability of employment and production at a high and rising level without inflation.¹⁰

Management of the public debt directly concerns taxpayers, because it affects the interest burden they must bear.¹¹ In the opinion of many financial authorities, however, the interest burden is of less economic importance than where the debt is held and when its various components mature. If the debt is not distributed among a sufficiently wide variety of lenders, monetary authorities are handicapped in trying to ease or tighten credit. For example, it is considered undesirable for banks to hold a disproportionate amount of federal securities because they can sell their "governments" and thereby obtain funds to make additional loans, thus circumventing efforts of the Federal Reserve System to restrict credit.

⁹ Congress had ignored a request by President Eisenhower in 1953 to raise the limit to \$290 billion.

¹⁰ Committee for Economic Development, *Managing the Federal Debt* (September 1954), pp. 3, 13-14.

¹¹ Total annual interest charges on the debt rose from \$5.3 billion in fiscal 1946 to \$7.3 billion in the fiscal year that ended last June 30.

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Equally or more important is the question of how much of the debt falls due at a given time. If too large a proportion of the total is in short-term securities, implementation of monetary policy is again hampered. According to former Under Secretary of the Treasury W. Randolph Burgess:

A large body of short-term debt increases the frequency as well as the volume of Treasury financing. It may constitute an irritant at times to the smooth operation of the market for short-term funds and for corporate and municipal securities. Also, to the extent that the anticipation, the announcement, the offering, and the digestion of new Treasury issues spreads over a large part of a year, the time available for the Federal Reserve to take appropriate credit and monetary policy actions may be restricted.

A large volume of short-term debt adds to the liquidity of banks and businesses and others who hold short-term government securities as practically a cash reserve. This makes . . . [such holders] less responsive to changes in monetary policy . . . [because] they can get cash readily by selling their short-term government securities.¹²

For those reasons, Burgess concluded, more than a "reasonable amount" of short-term debt "becomes undesirable."

EISENHOWER ADMINISTRATION'S HANDLING OF THE DEBT

To overcome what was considered an unsatisfactory debt structure, the Eisenhower administration set itself the goal in 1953 of broadening the distribution of the debt and stretching out the maturities. The President noted in his first State of the Union message that "Too great a part of the national debt comes due in too short a time." He said the Treasury would "undertake at suitable times a program of extending part of the debt over longer periods and gradually placing greater amounts in the hands of longer-term investors." The Treasury's successes and failures in attempting to accomplish that objective were detailed last summer by Secretary Humphrey, Under Secretary Burgess, and other officials in a lengthy series of hearings before the Senate Finance Committee.¹³

Between December 1952 and December 1956 the Treasury managed to get a larger amount of the debt into the hands of some long-term investors but not others. Mainly as a result of increased sales of savings bonds, individuals

¹² Statement before Senate Finance Committee, July 29, 1957.

¹³ Humphrey's resignation as Treasury Secretary, accepted May 29, 1957, did not take effect until July 29. Burgess was confirmed as U.S. representative on the North Atlantic Council on July 3 but stayed on at the Treasury until the end of the summer.

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held \$1.5 billion more in federal securities at the end of 1956 than they had owned at the end of 1952. However, chiefly owing to liquidation of "governments" by insurance companies, the group of investors composed of savings institutions held \$1.7 billion less in federal securities toward the end of President Eisenhower's first term than they had at the beginning.

In the non-bank category of short-term investors—corporations, state and local governments, and foreign and international accounts—the value of federal security holdings increased by \$5.1 billion during the four-year period. But in another short-term category—the commercial bank class, where debt holdings can be the most inflationary—the volume of government "paper" dropped from \$63.4 billion at the end of 1952 to \$59.4 billion at the close of 1956; as a proportion of the total public debt; the commercial bank holdings declined from 24 to 21 per cent.

Although the government floated more intermediate and long-term issues under Humphrey's supervision than it had under that of his predecessor at the Treasury, the average maturity of the debt was not lengthened but slightly shortened. The average fell off from three years and ten months in December 1952 to three years and seven months in June 1957.¹⁴ Moreover, the value of marketable securities maturing in less than one year increased from \$42.9 billion at the end of 1952 to \$50.6 billion in mid-1957.

Reviewing Treasury efforts to stretch out debt maturities, Burgess informed the Senate Finance Committee on July 29 that:

When the new administration came in, . . . we began promptly the sale of long-term bonds. . . . In 1954 and 1955, we made substantial progress toward our objective by selling a large volume of intermediate-term securities, together with the \$2½ billion of . . . 40-year bonds, the longest bonds that had ever been sold since the Panama Canal issue. In 1956 and 1957, [however,] in the midst of the current tremendous capital boom, we have sold no new bonds and only a limited amount of intermediate-term notes.

Continuing his testimony on Aug. 2, Burgess said: "We made a very good start at doing this thing in 1953, 1954, and 1955, and then we ran into a market where you just could not do much at lengthening your debt. And so we

¹⁴ Burgess pointed out to the Senate Finance Committee, July 29, however, that the loss of three months during the preceding four and one-half years should be contrasted with the "loss of 29 months during the six preceding postwar years."

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have, for the period as a whole, . . . just about held our own." ¹⁵

Burgess was able to report some improvement in the amount of so-called floating debt—marketable issues due within one year plus non-marketable items redeemable virtually on demand. The total of floating debt dropped from \$74.6 billion at the end of December 1952 to \$66.7 billion in mid-1957, making a proportionate decline from 27.9 to 24.7 per cent of the whole public debt.

As for longer-term issues, marketable securities maturing in one to five years made up a slightly larger proportion of the total debt in June 1957 (14.3 per cent) than they had in December 1952 (12.4 per cent). "Governments" coming due in five to ten years represented only about three-fifths as much of the debt in mid-1957 (4.2 per cent) as they had in late 1952 (7 per cent). But marketable issues maturing in more than ten years accounted for a slightly bigger proportion in June 1957 (9.8 per cent) than in December 1952 (9 per cent).

Summarizing the efforts of the Eisenhower administration to improve the structure of the national debt, Burgess observed on July 29: "We have not always been able to move as fast as we might like toward our long-range objective of achieving a better debt distribution, but we have reduced the floating debt and the bank-held debt and so reduced the inflationary threat which the debt carries. In addition, we have widened the sale of savings bonds and reopened the market for long-term bonds."

ABILITY OF UNITED STATES TO CARRY LARGE PUBLIC DEBT

With the federal debt continuing at high levels and its structure resisting attempts at major modification, question arises as to whether the United States can indefinitely support such a load without harm to the economy. Many financial authorities agree that the dollar total of the debt is of less significance than the relation of the debt to the national income. They maintain that a rising public debt need cause comparatively little worry so long as it is accompanied by a rising national income.

As tax-paying capacity increases, the country's ability

¹⁵ Secretary Humphrey had told the Senate Finance Committee on July 10: "You cannot sell just what you want to sell. You have to sell what somebody is going to buy."

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to sustain indebtedness also increases. The United States has been able to undergo a vast expansion of its national debt without untoward results because the national economy has grown enough to take on the new obligations in stride.

RELATION OF NATIONAL DEBT TO NATIONAL INCOME
IN SELECTED YEARS

| End of year* | Public debt (billions) | National income (billions) | Debt as per cent of income |
|--------------|---------------------------|-------------------------------|----------------------------------|
| 1930 | \$16.2 | \$75.7 | 21.4 |
| 1939 | 40.3 | 72.7 | 55.4 |
| 1946 | 269.4 | 179.6 | 150.0 |
| 1952 | 259.1 | 290.2 | 89.3 |
| 1956 | 272.7 | 343.6 | 79.4 |
| 1957 | 270.5 | 358.1† | 75.5 |

*Debt at end of fiscal year; income at end of calendar year.

†Annual rate at end of June quarter.

SOURCES: Debt: Treasury Department; income: Commerce Department.

As shown in the accompanying table, the ratio of public debt to national income has been declining since World War II. By the end of fiscal 1957 the burden of the debt, measured by its relationship to national income, was only half as great as at the end of fiscal 1946, though still several times heavier than at the onset of the Great Depression.

The burden of the public debt on a per capita basis of measurement has been eased gradually during the past decade. Although the total debt was slightly larger last June 30 than on the same date in 1946, the debt per capita was considerably smaller as a result of population growth—\$1,581 in 1957 as compared with \$1,905 in 1946.

Thanks to increases in national income and population, the United States, according to Burgess, is "gradually growing up to the debt." As the former Under Secretary of the Treasury said last summer: "Even though the dollar amount of debt is not declining as much as we might wish, the debt still becomes somewhat less burdensome. . . . I think we ought to be actually reducing the debt, but even though we do not, the situation, from the economics of the country, is becoming a little better in spite of us." ¹⁰

¹⁰ Statement before Senate Finance Committee, July 29, 1957.

